

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
ROBERT P. SMITH	:	DETERMINATION
	:	DTA NO. 819410
for Redetermination of a Deficiency or for Refund of	:	
New York State Personal Income Tax under Article 22	:	
of the Tax Law and New York City Personal Income Tax	:	
under the Administrative Code of the City of New York	:	
for the Period January 1, 1998 through September 30, 1998.	:	

Petitioner, Robert P. Smith, 27 Reeds Road, Tinton Falls, New Jersey 07724, filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law and New York City personal income tax under the Administrative Code of the City of New York for the period January 1, 1998 through September 30, 1998.

A hearing was held before Dennis M. Galliher, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on November 21, 2003 at 10:15 A.M., with all briefs to be submitted by April 2, 2004, which date commenced the six-month period for the issuance of this determination. Petitioner appeared *pro se*. The Division of Taxation appeared by Mark F. Volk, Esq. (Barbara J. Russo, Esq., of counsel).

ISSUE

Whether petitioner was a person required to collect, truthfully account for and pay over withholding tax with respect to High Standards Installations, Inc., who willfully failed to do so thus becoming liable for a penalty equal to such unpaid tax under section 685(g) of the Tax Law.

FINDINGS OF FACT

1. During the period 1990 through March 1994 petitioner, Robert P. Smith, together with his brother, Kenneth Smith, were involved in the operation of an entity known as CDC Workroom, Inc, which was engaged in the carpet installation business. CDC Workroom, Inc., was located in New Jersey, and performed carpet installation work in New Jersey and New York. Petitioner has been involved in the carpet installation business since approximately 1979, initially serving an apprenticeship as a carpet installer, thereafter working as a carpet installer, and ultimately becoming more involved in the management of laborers who installed carpet. In operating CDC Workroom, Inc., petitioner was primarily involved with the labor and operational (carpet installation) aspects of the business while Kenneth Smith was primarily involved with the financial (office) aspects of the business. Kenneth Smith had previous experience in financial management matters, but did not have experience in the field of carpet installation.

2. In the later part of 1993, Kenneth Smith incorporated High Standard Installations, Inc., ("H.S.") a carpet installation business. The record is unclear as to the precise genesis of H.S., with petitioner describing its creation, in testimony, as the incorporation of a carpet installation business he had previously operated as a sole proprietorship for approximately eight years, with Kenneth Smith only joining the business at petitioner's request in 1993. In contrast, the record contains petitioner's affirmation (given in a related civil proceeding) that H.S. evolved from (or after) CDC Workroom, Inc., with Kenneth Smith being involved from 1990 forward. In either event, the record is consistent in that H.S. was formed as the result of the growth of a predecessor business or entity founded by petitioner.

3. Notwithstanding petitioner's founding, ownership of and involvement in the business or entity which preceded H.S., all of H.S.'s stock was owned by Kenneth Smith. No reason is specified for petitioner's lack of any ownership interest in H.S., beyond petitioner's assertion that he was unaware of the import, responsibilities, and potential consequences of different forms of business organizations. In this regard, petitioner stated that he always considered himself a co-owner (or "50 percent partner") in H.S.'s business with his brother Kenneth Smith.¹ Petitioner did hold the title of vice president.

4. H.S. began its actual operations as the successor to or continuation of the predecessor business or entity in or about March 1994. Its business was operated, at least initially, such that petitioner was primarily involved in obtaining and managing the materials and labor necessary to meet H.S.'s contractual installation obligations, while Kenneth Smith was primarily involved in managing the financial aspects of the business. H.S. employed approximately 4 office workers, 4 or 5 warehouse workers/drivers and, depending on the company's fluctuating workload, between 20 and 80 union certified carpet installers. Again, notwithstanding Kenneth Smith's ownership of all of the stock of H.S., petitioner expressed the hope and belief that he and his brother would each manage their respective parts of the business, that the business would continue to grow, and that petitioner and Kenneth Smith would equally split the profits generated by H.S.

5. During the period from 1994 through 1996, H.S. encountered financial problems as the result of failures in payments of its union benefits obligations, worker's compensation obligations, and withholding tax obligations, as well as other obligations to various vendors.

¹ In addition to H.S., petitioner formed and was the sole shareholder of an entity known as H.S. Installing Corp. ("Installing"). Installing was formed in 1994 for the purpose of entering into a lease of warehouse space sufficient to meet H.S.'s inventory storage needs. Installing did enter into such a lease in or about 1994, and H.S. utilized the leased space pursuant to a verbal agreement or understanding between Robert Smith and Kenneth Smith.

Petitioner, who attributes these problems to dishonesty and financial mismanagement by Kenneth Smith, was aware of these problems as of late 1996 or early 1997, or earlier. As of the end of 1996, H.S. owed approximately \$900,000.00 to various creditors, with the largest share of such debt represented by unpaid amounts owed for worker's compensation, union benefits, and taxes owed to the Internal Revenue Service ("IRS") and to the States of New Jersey and New York.

6. In September 1996, Kenneth Smith accepted employment with Concord Flooring, Inc., one of H.S.'s largest customers, allegedly to remove his salary from the obligations of H.S., and thereby improve its cash flow. He did not receive a salary from H.S. from the time of his employment move to Concord Flooring, but continued to own all of the stock of H.S.

7. Petitioner managed H.S., including all aspects of its ongoing daily operations, from the September 1996 date of Kenneth Smith's move to Concord Flooring through December 2, 1998. Petitioner had the authority to make purchases on behalf of H.S. and did so, and he had the authority to sign checks for the payment of ongoing business expenses, including office expenses, supplies purchases, inventory purchases, and payroll expenses, and he did so. Petitioner signed all of H.S.'s checks, either personally or by allowing others to affix his signature, by stamp, to H.S. checks. As the result of recommendations made by H.S.'s financial advisors, including its attorney, its CPA, and a financial management firm engaged to help rectify the outstanding debt problem, petitioner also caused payments to be made against such outstanding debt, including H.S.'s tax obligations. According to petitioner, H.S. was, during the year 1997, able to repay approximately \$500,000.00 of the \$900,000.00 in outstanding obligations. However, at the same time, and specifically through 1997 and into 1998 H.S., though current on its obligations to its vendors, and on its union benefits and worker's

compensation payments, was not able to remain current in its ongoing tax obligations, including specifically its withholding tax obligations to the State of New York. Petitioner explained that problems with H.S.'s cash flow resulted from Kenneth Smith's periodically removing sums of money from H.S., via wire transfer, thus leaving H.S. with insufficient funds to meet all of its obligations on an ongoing basis.

8. During the period from late 1996 through December 2, 1998, petitioner continued to receive his wages and other benefits, including a leased vehicle and its maintenance, from H.S. Petitioner devoted all of his working time to H.S.'s business, and was not employed elsewhere. He noted that his annual salary from H.S. for the years 1994 through 1996 had been approximately \$130,000.00. During 1998, petitioner's salary from H.S. totaled \$58,500.00. To maintain H.S.'s cash flow, petitioner and his wife took mortgage-based loans on their home and in turn made loans to H.S. Thereafter, petitioner caused H.S. to repay the loans as payments from customers were received by H.S.

9. Petitioner signed withholding and other tax returns and reports on behalf of H.S., under the title of president, including specifically New York State quarterly withholding tax reports for the year 1998. However, the taxes withheld from H.S.'s employees' paychecks during these quarterly periods were not remitted to New York. Petitioner, H.S.'s bookkeeper, and petitioner's wife, who had been placed on H.S.'s payroll by petitioner, worked through 1997 to review all of H.S.'s financial records in order to determine H.S.'s financial status. This review included the review of H.S.'s corporate bank account, from which petitioner became aware of some of the wire transfers made by Kenneth Smith. Petitioner described Kenneth Smith's actions as "looting" the company, ostensibly to support an extravagant lifestyle. Petitioner allegedly

confronted and pressured Kenneth Smith, seeking his return to H.S. and an end to any fund removals, but to no avail.

10. In November 1998, Kenneth Smith commenced an action in the Superior Court of New Jersey seeking removal of petitioner from H.S.'s premises and curtailment of all aspects of petitioner's authority with and on behalf of H.S. By a Temporary Restraining Order dated December 3, 1998, petitioner was ordered out of and barred from returning to H.S.'s premises. Petitioner disputed Kenneth Smith's claims in this action, including the claim that petitioner had mismanaged the company, and he asserted that he was a 50-percent owner of H.S. However, the Superior Court rejected petitioner's claims and issued a Continuing Permanent Order barring petitioner from involvement in H.S.'s business and access to its premises.

11. The Division of Taxation ("Division") determined that withholding taxes had not been remitted by H.S. for the quarterly periods ended March 31, 1998, June 30, 1998, and September 30, 1998, and for part of the quarterly period ended December 31, 1998 (specifically through December 2, 1998). As a result, on March 11, 2002, the Division issued four notices of deficiency to petitioner, as a person responsible to collect, account for and pay over withholding taxes on behalf of H.S., asserting a penalty equal to the unpaid withholding taxes for the noted periods, as follows:

NOTICE NUMBER	PERIOD ENDED	AMOUNT
L-020687757	03/31/98	\$ 4,848.42
L-020687756	06/30/98	\$ 7,602.01
L-020687755	09/30/98	\$ 9,522.23
L-020687754	12/02/98	\$ 8,018.55
TOTAL	-----	\$29,991.20

12. Petitioner challenged the foregoing notices by requesting a conciliation conference with the Division's Bureau of Conciliation and Mediation Services. A conference was held and by a Conciliation Order (CMS No. 192021) dated December 20, 2002, the Notice of Deficiency pertaining to the period ended December 2, 1998 was canceled, thus reducing the amount asserted as due and at issue in this proceeding to \$21,972.66. Petitioner does not challenge the dollar amount remaining at issue, or that such amount was not remitted as required, but rather asserts only that he should not be held responsible for its payment.

SUMMARY OF PETITIONER'S POSITION

13. Petitioner maintains that since he was not a shareholding owner of H.S., he should not be held responsible for its tax obligations. In this respect, he points to the undisputed fact that Kenneth Smith owned all of the stock of the corporation. He also points to the fact that through his efforts a substantial portion of the outstanding obligations of H.S. were repaid during the year 1997, after Kenneth Smith went to work for Concord Flooring and while petitioner was managing H.S.'s affairs. Petitioner alleges that his efforts to make further payments, including ongoing tax payments for the quarterly periods in issue, were hindered by Kenneth Smith's periodic removal of sums of money, by wire transfer, from the account of H.S., thus leaving petitioner unable to meet the corporation's ongoing expenses in full on a timely basis.

CONCLUSIONS OF LAW

A. With regard to the withholding tax penalty asserted against petitioner, Tax Law § 685(g) provides:

Willful failure to collect or pay over tax.--Any person required to collect, truthfully account for, and pay over the tax imposed by this article who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payments thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the

total amount of the tax evaded, or not collected, or not accounted for and paid over.

B. Tax Law § 685(n), in turn, furnishes the following definition of “persons” subject to the section 685(g) penalty:

The term person includes an individual, corporation or partnership or an officer or employee of any corporation (including a dissolved corporation), or a member or employee of any partnership, who as such officer, employee or member is under a duty to perform the act in respect of which the violation occurs.

C. The question of whether someone is a “person” under a duty to collect and pay over withholding taxes is a factual one, and has been litigated many times. Factors which should be considered include whether the particular individual had the authority to sign tax returns and did so, derived a substantial part of his income from the business, or had the right to hire and fire employees (*Matter of Malkin v. Tully*, 65 AD2d 228, 412 NYS2d 492, 494, *affd* 49 NY2d 920, 428 NYS2d 675). Other pertinent areas of inquiry include the person’s official duties, his authority to pay obligations of the business, and his financial interest in the business (*Matter of Amengual v. State Tax Commn.*, 95 AD2d 949, 464 NYS2d 272,273; *see, Matter of McHugh v. State Tax Commn.*, 70 AD2d 987, 417 NYS2d 799, 801; *Matter of Shah*, Tax Appeals Tribunal, February 25, 1999). Summarized in terms of a general proposition, the issue to be resolved is whether petitioner had, or could have had, sufficient authority and control over the affairs of the business to be considered a person under a duty to collect and remit the unpaid taxes in question (*Matter of Constantino*, Tax Appeals Tribunal, September 27, 1990; *Matter of Chin*, Tax Appeals Tribunal, December 20, 1990).

D. In addition, if petitioner is held to be a person under a duty as described, it must then be decided whether his failure to withhold and pay over such taxes was willful. The question of willfulness is related directly to the question of whether petitioner was a person under a duty,

since clearly a person under a duty to collect and pay over the taxes is the one who can consciously and voluntarily decide not to do so. However, merely because one is determined to be a person under a duty, it does not automatically follow that a failure to withhold and pay over income taxes is “willful” within the meaning of that term as used in Tax Law § 685(g). As the Court of Appeals indicated in *Matter of Levin v. Gallman* (42 NY2d 32, 396 NYS2d 623), the test is:

[w]hether the act, default, or conduct is consciously and voluntarily done with knowledge that as a result, trust funds belonging to the Government will not be paid over but will be used for other purposes No showing of intent to deprive the Government of its money is necessary but only something more than accidental non-payment is required (*id.*, 396 NYS2d at 624-625; *see, Matter of Lyon*, Tax Appeals Tribunal, June 3, 1988).

The failure to pay over taxes can be willful notwithstanding the lack of actual knowledge, if the person recklessly disregarded his responsibilities, including the responsibility to see that employment taxes are paid (*Matter of Capoccia v. State Tax Commn.*, 105 AD2d 528, 481 NYS2d 476). Finally, “corporate officials responsible as fiduciaries for tax revenues cannot absolve themselves merely by disregarding their duty and leaving it for someone else to discharge” (*Matter of Risoli v. Commr.*, 237 AD2d 675, 654 NYS2d 218, quoting *Matter of Ragonese v. State Tax Commn.*, 88 AD2d 707, 451 NYS2d 301).

E. Upon review of the entire record, it becomes clear that petitioner was properly held responsible for the withholding tax obligations of H.S. for the periods in issue. In order to prevail in this case, petitioner was required to establish by clear and convincing evidence that he was not under a duty to act on behalf of H.S., i.e., that he lacked the necessary authority, or he had the necessary authority but he was thwarted by others in carrying out his duties (*Matter of Goodfriend*, Tax Appeals Tribunal, January 15, 1998). Neither of these circumstances accurately describes the facts of this case.

F. Petitioner's position and his role in H.S. clearly leave him responsible for the unpaid tax in question. Petitioner founded the business which was incorporated as H.S., and worked for H.S. from its incorporation in late 1993 through December 2, 1998. It is undisputed that petitioner managed all aspects of H.S.'s business on a day-to-day basis both before and during the period in issue, including paying bills, and arranging for, hiring, and paying employees, including H.S.'s bookkeeper, until such time as he was removed from the company. Petitioner was an officer of H.S., holding the title of vice-president, he signed its tax returns, including withholding tax returns, using the title "president," and signed all of its checks. Petitioner always considered himself a half owner of the business. He received his salary as well as other benefits, such as the lease and maintenance of a vehicle, from the company. He was aware not only of the outstanding prior obligations of the company, but was fully aware of the fact that ongoing obligations, including specifically the taxes at issue, were not being met on a current basis. Petitioner was a signatory and had full access to H.S.'s bank account, and was fully aware of the status of H.S.'s accounts receivable and accounts payable, and he knew which bills were, and were not, being paid. He chose to pay those expenses which enabled the company to continue in operation, and not other expenses including the taxes in question. Petitioner apparently made yeoman efforts to pay off the outstanding past-due obligations of the business he started and fervently hoped to return to profitability.² While it appears he may have been hindered in these efforts by fund removals by Kenneth Smith, it remains that petitioner

² In October 1998, petitioner opened a new H.S. bank account, deposited \$112,000.00 of checks from collected accounts receivables in such account and, when the checks cleared, caused three Treasurer's checks totaling \$110,000.00 to be made payable to the I.R.S., claiming he did this out of concern that Kenneth Smith might otherwise divert the funds out of the company to his own use. This payment to the I.R.S. was set aside in the Superior Court action and the funds were returned to H.S.

consciously chose which bills he would pay on behalf of the company and which he would not, including New York withholding taxes.

G. The evidence does not lead to a conclusion that petitioner did not possess or could not have exercised sufficient authority and control over H.S.'s affairs during the periods at issue so as to have paid the taxes in question (*see, Matter of Shah*, Tax Appeals Tribunal, February 25, 1999), was misled by reasonable reliance upon others as to the status of H.S.'s tax obligations, or was unaware of the nonpayment of the taxes in question. Tax Law § 685(n) is clear that officers or employees of a corporation (and not only shareholders) are specifically included within the definition of "persons" who may be under a duty, pursuant to Tax Law § 685(g), to collect, account for and pay over withholding taxes. Petitioner's actions with the company during the periods in issue clearly establish that he was such an officer and employee with the authority to cause the payment of the taxes at issue in a timely manner, who willfully failed to do so. The possibility that Kenneth Smith, as the owner of H.S., might also have been under such an obligation to collect, account for and pay over taxes, does not negate petitioner's status as a person responsible or absolve him of liability. Accordingly, the Division properly held petitioner responsible for the unpaid taxes in question.

H. The petition of Robert P. Smith is hereby denied, and the notices of deficiency at issue in this proceeding, dated May 11, 2002 and pertaining to the quarterly periods spanning January 1, 1998 through September 30, 1998, are sustained.

DATED: Troy, New York
August 26, 2004

/s/ Dennis M. Galliher
ADMINISTRATIVE LAW JUDGE